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Ms. Mary Rupp  
Secretary of the Board  
National Credit Union Administration  
1775 Duke Street  
Alexandria, Virginia 22314-3428

This letter is the response of the Audit Committee of Advantis Credit Union to the "Advance Notice for Proposed Rulemaking -- Supervisory Committee Audits".

A few general comments first:

- The cost of doing this under SOX section 404 for publicly traded companies was enormous for the first reporting cycle. The average cost for companies with market capitalization between \$75M and \$700M, deemed "smaller companies" in a study by CFO Direct for the Big 4 accounting firms, was \$1.9M for the first year. The study goes on to suggest that for these smaller companies it may not decline appreciably in the second year. The study reports that of the total cost of section 404 implementation only 26% was for the external audit. It is not easy to compare CUs and publicly-traded companies but the cost will be detrimental to CUs.

As an example, a Portland area CU asked their CPA for a rough estimate of the fees for performing the attestation and they were told it would be around \$150K. Using the percentage from above the total cost to this credit union could approach \$577K.

- At the CUNA GAC Conference this year two commissioners stressed their desire to keep paperwork to a minimum. While the attestation does not present paperwork filed with NCUA it nevertheless represents a huge documentary process for CUs
- Credit unions are scrutinized fairly intently through regulatory exams. Also a large share of CUs have external audits of the financial statements
- What is the perceived risk being addressed by the ANPR? There

has not been any fraudulent reporting to our knowledge. CU accounting is rather bland without numerous areas requiring management estimation, few exotic off-balance sheet transactions or timing issues.

responses to the 22 questions in the ANPR follow:

- 1. Should part 715 require, in addition to a financial statement audit, an “attestation on internal controls” over financial reporting above a certain minimum asset size threshold? Explain why or why not.**

The issue is one where it is necessary to weigh the costs and benefits associated with the attainment.

The cost of obtaining the attestation from an independent auditor is enormous (one local CU of about \$750M in assets got a rough bid and it was 5 times the annual audit fee.), That is not the end of the expense to the CU – there are considerable, less-easily quantified internal costs to prepare for the attestation and ongoing maintenance. It is almost inevitable that a CU will have to hire at least one permanent employee to maintain the documentation and monitor. This is what has happened in publicly traded companies (although they usually have several individuals to perform the tasks).

What is the benefit to credit union members? SOX is an attempt to protect those who hold shares in a publicly traded company because of the losses suffered in the past through management manipulation.

A credit union is inherently less risky than state and federal bank and savings and loans. The incentives for fraudulent reporting are significantly reduced in the credit union industry. It would seem the disparity in financial and control reporting requirements that exist between credit unions and other types of financial institutions is in fact justified.

This costly process will undoubtedly take resources from CUs that could be helping members such as first-time home buyers and other programs for those in the lower economic strata. It may even adversely impact loan and savings rates for members. Considering

that members are covered by insurance for losses there can be no benefit to them from the attestation.

The need for this attestation becomes even less when you consider that every CU has an independent audit and is visited by a state and/or federal regulatory examiner annually.

2. **What minimum asset size threshold would be appropriate for requiring, in addition to a financial statement audit, an “attestation on internal controls” over financial reporting, given the additional burden on management and its external auditor? Explain the reasons for the threshold you favor.**

As those institutions regulated by the FDIC are inherently riskier and their threshold is \$1B a higher figure would be appropriate for CUs. It would seem that a threshold no lower than \$1.5B is reasonable.

3. **Should the minimum asset size threshold for requiring an “attestation on internal controls” over financial reporting be the same for natural person credit unions and corporate credit unions? Explain why.**

Given the nature of both types of institutions, there appears to be no rationale for having different thresholds

4. **Should management’s assessments of the effectiveness of internal controls and the attestation by its external auditor cover all financial reporting, (i.e., financial statements prepared in accordance with GAAP and those prepared for regulatory reporting purposes), or should it be more narrowly framed to cover only certain types of financial reporting? If so, which types?**

Credit unions don’t have financial statement users in the sense of the shareholder investment community so any covered reporting should be limited to reporting for regulatory purposes only (e.g. call reports).

5. **Should the same auditor be permitted to perform both the financial statement audit and the “attestation on internal controls” over financial reporting, or should a credit union be allowed to engage one auditor to perform the financial statement audit and another to perform the “attestation on internal controls?” Explain the reasons for your answer.**

Efficiencies may be gained by integrating internal control reviews with financial audits so this should be allowed. But the ability to shop for the best price should not be eliminated. The critical issue is independence which can be obtained in either scenario.

**6. If an “attestation on internal controls” were required of credit unions, should it be required annually or less frequently? Why?**

It would seem to make sense that, due to the risk profile of CUs, less frequent attestations are adequate. Perhaps every 3 years.

**7. If an “attestation on internal controls” were required of credit unions, when should the requirement become effective (i.e., in the fiscal period beginning after December 15 of what year)?**

It is a very labor-intensive endeavor to document, assess and remedy. SOX deadlines were extended for smaller filers and CUs will require similar lengths of time to prepare. At least 2 and maybe 3 years is needed to prepare without having to drive the cost up even more by forcing CUs to hire consultants to meet accelerated deadlines.

**8. If credit unions were required to obtain an “attestation on internal controls,” should part 715 require that those attestations, whether for a natural person or corporate credit union, adhere to the PCAOB’s AS 2 standard that applies to public companies, or to the AICPA’s revised AT 501 standard that applies to non-public companies? Please explain your preference.**

The AICPA’s revised AT 501 standard is preferable to the PCAOB’s AS 2 standard, as CUs more closely resemble non-public companies and there is more flexibility.

**9. Should NCUA mandate COSO’s Internal Control – Integrated Framework as the standard all credit union management must follow when establishing, maintaining and assessing the effectiveness of the internal control structure and procedures, or should each credit union have the option to choose its own standard?**

Yes as this is a recognized and widely understood model. It seems using one model may provide a level of comparability. Also if a CU changes auditors the learning curve may be reduced.

- 10. Should Audit Committee members of credit unions above a certain minimum asset size threshold be required to have a minimum level of experience or expertise in credit union, banking or other financial matters? If so, what criteria should they be required to meet and what should the minimum asset size threshold be?**

The concept is valid but the execution in a volunteer world is very problematic; finding plain vanilla volunteers is not always that easy. It seems that CUs should be strongly encouraged to find an expert and the effort they make should be documented should they fail. Any threshold should mirror the amount decreed in response 2 above.

The whole issue also raises another concern from the SOX world. Does the financial expert have more at risk and should the D&O insurance coverage be increased – once again here is a cost and at what benefit.

- 11. Should Audit Committee members of credit unions above a certain minimum asset size threshold be required to have access to their own outside counsel? If so, at what minimum asset size threshold?**

This is a critical component to having a viable committee able to perform its duties (usually during a problem incident). They should definitely have this capability and it should not just be counsel. It may be they might need other services such as a forensic accountant.

- 12. Should Audit Committee members of credit unions above a certain minimum asset size threshold be prohibited from being associated with any large customer of the credit union other than its sponsor? If so, at what minimum asset size threshold?**

This seems to be an issue of independence and as such a threshold is not relevant. The Committee does not approve loans, rates or other transactions (presuming these would fall into your definition of an association) so it does not seem likely that a question of independence will arise. Therefore there does not need to be any prohibition based on association.

- 13. If any of the qualifications addressed in questions 10, 11 and 12 above were required of Audit Committee members, would credit unions have difficulty in recruiting and retaining competent individuals to serve in sufficient numbers? If so, describe the obstacles associated with each qualification.**

Item 11 seems to have no impact on the ability to recruit volunteers since it mandates the availability of counsel. If there was no such requirement there might be some who would not wish to serve given this ability is the norm in companies that follow best practices.

If 10 and 12 were required they would put up roadblocks to efficiently finding volunteers. The comments provided for question 10 gives the supporting rationale for this response. As to question 12, any time you limit the field of possible choices you are creating obstacles. There are probably not a lot of financial experts in any event and if you then further eliminate those with this "association" it makes the population of possible candidates even smaller.

- 14. Should a State-licensed, compensated auditor who performs a financial statement audit and/or "internal control attestation" be required to meet just the AICPA's "independence" standards, or should they be required to also meet SEC's "independence" requirements and interpretations? If not both, why not?**

Independence is critical to a reliable financial statement audit. The most restrictive standard should be adopted.

- 15. Is there value in retaining the "balance sheet audit" in existing §715.7(a) as an audit option for credit unions with less than \$500 million in assets?**

Yes, but the threshold is too high. CUs above \$100M can afford and should be required to have an independent audit of the full set of financial statements and accompanying footnotes by a professional firm.

- 16. Is there value in retaining the "Audit Committee Guide audit" in existing §715.7(c) as an audit option for credit unions with less than \$500 million in assets?**

Yes, but the threshold is too high. CUs above \$100M can afford and should be required to have an independent audit performed by a qualified CPA firm

- 17. Should part 715 require credit unions that obtain a financial statement audit and/or an "attestation on internal controls" (whether as required or voluntarily) to forward a copy of the auditor's report to NCUA? If so, how soon after the audit period-end? If not, why not?**

The reports should not be forwarded unless there is a material weakness or a qualified opinion. NCUA may have need for this information but they can wait until the next field audit for "clean reports".

When a report is to be forwarded, it should be within 20 days of receiving the report from the issuer.

- 18. Should part 715 require credit unions to provide NCUA with a copy of any management letter, qualification, or other report issued by its external auditor in connection with services provided to the credit union? If so, how soon after the credit union receives it? If not, why not?**

Same answer as # 17. above.

- 19. If credit unions were required to forward external auditors' reports to NCUA, should part 715 require the auditor to review those reports with the Audit Committee before forwarding them to NCUA?**

Yes, the Audit Committee should have the opportunity to review the reports with the auditors before the reports are transmitted to the NCUA.

- 20. Existing part 715 requires a credit union's engagement letter to prescribe a target date of 120 days after the audit period-end for delivery of the audit report. Should this period be extended or shortened? What sanctions should be imposed against a credit union that fails to include the target delivery date within its engagement letter?**

The 120 days is adequate. To the extent major issues arise from the



audit it is better to know sooner rather than later.

- 21. Should part 715 require credit unions to notify NCUA in writing when they enter into an engagement with an auditor, and/or when an engagement ceases by reason of the auditor's dismissal or resignation? If so in cases of dismissal or resignation, should the credit union be required to include reasons for the dismissal or resignation?**

It is not necessary to notify the NCUA upon engaging an auditor.

Dismissal or resignation of an independent auditor outside of the original term of the engagement should be an event that would require notification. The notification should include the rationale. A copy should be provided to the auditor so they can dispute the reason if they do not believe the reason is accurate. All that being said, if NCUA just files it away then why bother?

- 22. NCUA recently joined in the final Interagency Advisory on the Unsafe and Unsound Use of Limitation of Liability Provisions in External Audit Engagement Letters, 71 FR 6847 (Feb. 9, 2006). Should credit union Audit Committees be prohibited by regulation from executing engagement letters that contain language limiting various forms of auditor liability to the credit union? Should Audit Committees be prohibited from waiving the auditor's punitive damages liability?**

Regulatory prohibition seems reasonable in both cases.

Sincerely,



K. D. Johnsen, CPA  
Audit Committee Chair  
Member of the Board of Directors